In The

Supreme Court of the United States

October Term 1972

Nos. 72-486 and 72-488

Federal Power Commission,
Petitioner

v.

Memphis Light, Gas & Water Division, et al,
Respondents

Texas Gas Transmission Corporation
Petitioner

v.

Memphis Light, Gas & Water Division, et al,
Respondents

AMICUS CURIAE BRIEF OF INDEPENDENT NATURAL GAS ASSOCIATION OF AMERICA

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AMICUS CURIAE BRIEF OF INDEPENDENT NATURAL GAS ASSOCIATION OF AMERICA

The Independent Natural Gas Association of America ("INGAA") respectfully submits this brief as *amicus curiae* in support of Petitioners, Federal Power Commission and Texas Gas Transmission Corporation. It is INGAA's basic position that the Court below misconstrued § 441(a) of the Tax Reform Act of 1969 and that its decision reversing the Federal Power Commission in *Texas Gas Transmission Corporation*, Opinions 578 and 578-A should be reversed. INGAA's interest is set forth in its Motion for Leave to File Amicus Curiae Brief.

ARGUMENT

Background

Liberalized or accelerated depreciation was first permitted by the Internal Revenue Code of 1954. Thereafter, finding that the use of liberalized depreciation would result in a "deferral" of taxes, the Commission adopted a policy of permitting regulated utilities to "normalize" taxes in computing cost of service for rate purposes. This being regarded as a matter within the Commission's special expertise "as a trier of facts", its determination was uniformly upheld by the courts. *Cities of Lexington, Ky. et al* v. *Federal Power Commission,* 295 F.2d 109, 113 (4th Cir. 1961); *El Paso Natural Gas Company* v. *Federal Power Commission,* 281 F.2d 567 (5th Cir. 1960), cert. den. 366 U.S. 912.

Subsequently, the Commission in *Alabama-Tennessee Natural Gas Company* 31 FPC 208 (1964) reversed its position and found that continuing pipeline expansion could reasonably be anticipated for the foreseeable future and that, consequently, depreciation charges on future plant additions under liberalized depreciation rules would offset the decline in depreciation on existing plant. It concluded, therefore, that the use of liberalized depreciation resulted in a tax saving for the utility rather than merely a tax deferral. Based on this finding, the Commission required the pipelines to compute their cost of service on actual taxes. rather than normalized taxes and to "flow-through" the benefits of liberalized depreciation in the form of reduced rates.[2]

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[1] The terms "flow-through" and "normalization" and their respective tax and rate consequences are described and discussed in detail in *City of Chicago* v. *FPC,* 385 F.2d 629 (D.C. Cir. 1967), cert. den. 390 U.S. 945; *Alabama-Tennessee Natural Gas Co.* v. *FPC,* 359 F.2d 318, cert. den. 385 U.S. 847; *Panhandle Eastern Pipeline Co.* v. *FPC,* 316 F.2d 659 (D.C. Cir. 1963),

Significantly, the Commission did not reject the concept of normalization. It held merely that the facts and circumstances then existing "make it apparent that normalization is premature." 31 F.P.C. at 216.

Again, the Commission was affirmed by the courts, the matter being regarded as one involving regulatory discretion. *Alabama-Tennessee Natural Gas Co.* v. *Federal Power Commission*, 359 F.2d 318 (5th Cir. 1966) cert. den. 385 U.S. 847; *City of Chicago, et al* v. *Federal Power Commission*, 385 F.2d 629 (D.C. Cir. 1967), cert. den. 390 U.S. 945. In affirming, the Fifth Circuit characterized the Commission's finding that liberalized depreciation would result in a tax saving as "fundamental" and "critical" and held that while it necessarily constituted merely "a fair guess as to future conditions," it was adequately supported. *Alabama-Tennessee Natural Gas Co.* v. *Federal Power Commission, supra*, 359 F.2d at 318, 323, 332.

In *Midwestern Gas Transmission Company* 36 F.P.C. 61 (1966), which followed the affirmance of *Alabama-Tennessee*, the Commission imputed the use of flow-through accounting in determining the rates of Midwestern although that company had elected to utilize straight-line depreciation. The Commission based its decision on a finding of abuse of management discretion in the selection of depreciation methods. It was again affirmed, *Midwestern Gas Transmission Co.* v. *Federal Power Commission*, 388 F.2d 444 (7th Cir., 1968) cert. den. 392 U.S. 928, the Court concluding that the record supported the Commission in its "favorable estimates of future plant growth." 388 F.2d at 447.

Section 441(a) of the 1969 Act represents congressional

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cert. den. 375 U.S. 881; and *Cities of Lexington, Ky. et al.* v. *FPC*, 295 F.2d 109 (4th Cir. 1961). This is not a subject which is new to the Commission, the courts, or Congress.

response to *Alabama-Tennessee* and *Midwestern* and to similar decisions by other regulatory agencies. It provides the mechanics for eliminating the premise on which the flow-through requirement was based, namely that depreciation deductions on future plant under liberalized depreciation rules would *in fact* offset the decline in deductions on existing plant and thus produce a tax saving to the utility. For the utility making the election provided for in § 441(a), this would not be the case.[3] Contrary to the holding of the Court below, the amendment contemplated the discontinuation of flow-through and the use of normalization accounting with agency approval when normalization was no longer "premature".

THE HOLDING OF THE COURT BELOW

The lower court erroneously held, INGAA submits, that the 1969 Act compels the utilities, which were basing their rates on flow-through at the time the Act was adopted, to continue to do so with respect to existing property without regard to changed circumstances and without regard to the effect flow-through might have on such utilities, on the rates which they charge or on the customers which they serve. The decision of the Federal Power Commission in Opinions 578 and 578-A permitting Texas Gas Transmission Corporation to change from flow-through accounting to normalization with respect to existing property was said to produce an effect "precisely contrary to that envisioned by Congress."

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[3] In addition to changes in the tax laws other circumstances have changed significantly since 1964 when *Alabama-Tennessee* was decided. Then the Commission anticipated adequate gas reserves to support pipeline expansion at least through 1980 and saw no significant decline in reserves prior to the twenty-first century. See *Alabama-Tennessee Natural Gas Co.* v. *Federal Power Commission, supra*, 359 F.2d at 338; *Midwestern Gas Transmission Co.* v. *Federal Power Commission, supra*, 388 F.2d at 447. The current shortage of natural gas is a matter of judicial notice.

462 F.2d at 863.[3] Reversing the Commission, the Court states:

> ". . . since Texas Gas has been employing liberalized depreciation with flow-through, it is *specifically prohibited*, under the final version of the bill from abandoning such depreciation. . . ." 462 F.2d at 863.[4]

This simply is not so.

THE AMENDMENTS ADOPTED BY THE 1969 ACT

Their Purpose and Purport

The principal thrust of the 1969 amendments relating to liberalized depreciation was to prevent prospective tax revenue losses as the result of the regulatory agencies' requiring or imputing flow-through accounting in establishing utility rates and generally to decelerate the trend toward faster methods of depreciation.[5] Following references to these matters, the House Committee Report states:

> "Your committee has been advised that, if those trends were to continue, there could very shortly be a revenue loss of approximately $1.5 billion; some estimates indicate that the loss might be considerably closer to

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Cf. Federal Power Commission v. *Louisiana Power & Light Company et al.*, 406 U.S. 621 (1972) in which the Court quoted from an FPC Staff Report which stated: "The emergence of a natural gas shortage during the past two years marks an historic turning point — the end of natural gas industry growth uninhibited by supply considerations." 406 U.S. at p. 626.

[3] For convenience, post-1969 expansion property is referred to as "expansion property." Pre-1970 property and post-1969 non-expansion property is referred to as "existing property."

[4] Emphasis in quotations added unless otherwise indicated.

[5] Such agency action was referred to in the report of the Senate Committee staff as the "[p]roblem." In the House and Senate reports, the discussion of these decisions is set out under the heading "General Reasons for Change." H. Rept. No. 91-413, U.S. Code Cong. and Ad. News, Vol. 2, 1969 p. 1782; S. Rept. No. 91-552, *ibid*, p. 2204.

> $2 billion per year. Your committee has determined that the likely revenue loss from wholesale shifts to accelerated depreciation and flow-through is unacceptable at this time." H. Rept. No. 91-413, U.S. Code Cong. and Ad. News, Vol. 2, 1969 p. 1783.

The lower court correctly recognized this problem as a "prime consideration" of Congress. Specifically, it stated:

> "This overall congressional objective to forestall prospective revenue losses, without handicapping the utility industry, was a prime consideration at all stages of the legislation." 462 F.2d at 868.

Unaccountably, however, it failed to read the statute and its legislative history with this objective in mind. A change *from* flow-through to normalization, such as that permitted Texas Gas in Opinions 578 and 578-A, serves to increase rather than decrease tax revenues. The Commission's decision was therefore completely consistent with the stated objective of the Act. It was the *reverse* of this situation, *i.e.*, changes from normalization *to* flow-through and the imputation of flow-through, both of which serve to *reduce* taxes, with which Congress was concerned.

The Limitation on Agency Discretion

Congress clearly undertook by the adoption of § 441(a) to limit agency discretion, but not in the manner held by the court below and certainly not through any arbitrary and immutable "freeze." It approached the problem of agency decision requiring flow-through accounting indirectly by specifying the particular depreciation methods which would constitute "reasonable allowance[s]" under various circumstances, and thus eliminating both *agency* and *management discretion* to employ any other method for tax or rate purposes. The lower court failed to recognize this.

A finding of an abuse of management discretion in the selection of a depreciation method, as in *Midwestern*, is the sole basis for the imputation of flow-through. Thus the designation of particular methods under particular circumstances removes the basis for imputing flow-through and requires the agency to base the utilities' rates on the particular method prescribed by the Act. As an example, agency discretion with respect to pre-1970 property to require flow-through by a utility that is employing liberalized depreciation with normalization is curtailed by § 441(a)(1)(A). That section permits liberalized depreciation *only* if the taxpayer uses a normalization method of accounting. Thus, if the regulatory agency undertakes to require flow-through, the Act provides that the only "reasonable [depreciation] allowance" would be that computed from the use of straight-line depreciation. As straight-line depreciation deductions would constitute the only reasonable allowance, the agency would be required to recognize them in fixing rates. Similarly, with respect to the election provision, if the agency does not permit normalization, the utility is required to utilize straight-line deprecation. As the Senate Committee Report regarding the provision states, under these circumstances "the agency would not be able to impute the use of accelerated depreciation with flow-through". S. Rept. No. 91-522, U.S. Code Cong. and Ad. News, Vol. 2, 1969 p. 2206.

The same is not true, however, with respect to the Act's treatment of the discontinuation of flow-through. Changes from flow-through to normalization do not decrease tax revenues. They increase them. Consequently, they serve the principal objective of the 1969 amendments, and regulatory agency discretion with respect thereto was not curtailed.[6]

THE ELECTION PROVISION

In its construction of the Act, the lower court reads the election provision as the *only means* by which a utility utilizing liberalized depreciation with flow-through could change to normalization. This, it seems to INGAA, is the root of the lower Court's error.

The election provision first appeared in the Senate version of the Act. Pointing to it, the Court states:

> "... the Senate limited (the Commission and Texas Gas can point to no language to the contrary) *all* changes [from flow-through] re both expansion and non-expansion property to a 180-day election." 462 F.2d at 867.

The Court reasons that when the Senate version of the election, which covered all property, was limited in conference to expansion property only, the ability of the regulated utility to discontinue flow-through, *with or without agency consent,* was thereby limited to expansion property. It finds support for this conclusion from references in the various reports of an intent to "freeze" the current situation.

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[6] The comment in the General Explanation quoted by the Court, 462 F.2d at 868, that the related section of the Act does not affect the agency's power "to require the taxpayer to flow through" relates *solely* to the limited situation in which the utility was taking accelerated depreciation and flowing-through as of August 1, 1969. In such cases *only,* the Commission in the exercise of its discretion could require the continuation of flow-through or impute flow-through if the utility undertook to change to straight line other than through utilization of the election procedure. On the other hand, the reports of both Houses clearly established that the Commission, also in the exercise of its discretion, could permit a change from flow-through *to* either straight-line or liberalized depreciation with normalization.

The Court is wrong. The language of the Act itself is contrary to its conclusion. As finally adopted, § 441(a)(1)(B) provides that with respect to pre-1970 public utility property, the taxpayer which had been utilizing a flow-through method of accounting *"may"* use the applicable 1968 method for such property. The Court, however, has read this section of the Act as providing that the taxpayer *"must"* use the applicable 1968 method and continue flow-through without regard to the consequences.

The right of the utility to change from flow-through to normalization with respect to existing property under the Act is further confirmed by the Senate report relating to its version of § 441(a)(1), which was carried forward virtually unchanged into the Act as finally adopted. The report states:

> "Both the House bill and the [Senate] committee amendments provide that in the case of existing property the following rules are to apply:
>
> (1) If straight line depreciation is presently being taken, then no faster depreciation is to be permitted as to that property.
>
> (2) If the taxpayer is taking accelerated depreciation and is 'normalizing' its deferred taxes, then it must shift to the straight line method unless it continues to normalize as to that property.[7]
>
> (3) If the taxpayer is taking accelerated depreciation and flowing through to its customers the benefits of the deferred taxes, then the taxpayer would continue to do so (except as provided under the committee amendments which are discussed below), *unless the appropriate regulatory agency permits a change as to that property.*" (S. Rept. No. 91-552, U.S. Code Cong. and Ad. News, Vol. 2, 1969, p. 2205.

[7] i.e., the regulatory agency cannot *require* flow-through.

Except for the parenthetical phrase, which refers to the election provision and a change of the language in paragraph (3) from "must continue" to "would continue" the Senate Report's explanation is identical with that set forth in the House Report regarding its version of the Act which contained no election provision. The italicized clause indicates Senate intent that in addition to changes available as a matter of right pursuant to the election provision, changes from flow-through to normalization would be permissible with agency approval. Otherwise the clause has no meaning. Thus rather than "specifically prohibit[ing]" the discontinuation of flow-through, as the lower Court held, the Act specifically recognizes that such discontinuation may occur.

The lower Court agreed that under the House version of the Act Texas Gas could have been permitted a change from flow-through to normalization on existing property with agency approval. 462 F.2d at 862. It compares the House bill, however, with the Senate bill, which contains the same provisions and explanation but which added the further right in the utility to elect within 180 days to discontinue flow-through with respect to all property, and concludes that the limitation of the scope of the election to expansion property in the Act as adopted prevents *all other changes,* even though made with agency approval.[8] This simply does not follow.

Nor is the lower court correct in its belief that leaving discretion with the Commission to permit a change from flow-through to normalization expands the election provi-

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[8] The Conference Report states simply that the election provision has been "modified to apply to new [expansion] property and not to replacement property." Conference Report No. 91-782, U.S. Code Cong. and Ad. News, Vol. 2., 1969, p. 2427.

sion to cover "all property". 462 F.2d at 870. The Court has failed to recognize the distinction, which Congress preserved in the Act, between (1) property with respect to which the utility has the right to discontinue flow-through without agency approval (expansion property when the election has been made) and (2) property with respect to which it must obtain agency *permission* to discontinue flow-through (all other property including expansion property when the election has not been made). The fact that the regulatory agencies were required by the final version of the Act to recognize straight-line depreciation or normalization with respect to expansion property only does not mean they were denied authority to *permit* changes from flow-through to normalization with respect to property as to which an election was not available or was not exercised.

The election provision was written into the Act as a separate and distinct right conferred upon the utility to discontinue flow-through accounting on expansion property by "electing" to do so within the 180-day period prescribed. By refusing to consent to normalization, the agencies could force the use of straight-line depreciation. They could not, however, prevent the discontinuation of flow-through with respect to such property. The utility's right in this respect was separate, apart from and in addition to its right to request agency permission to discontinue flow-through and the agency's discretion to grant that request. Both the Act and its legislative history confirm this.

The Court is fundamentally wrong in its statement that "Congress has pondered the question [of permitting the discontinuation of flow-through when liberalized depreciation no longer results in a tax saving] and has exercised what was formerly the FPC's prerogative for it." 462 F.2d at 864.

Neither the election provision nor any other provision of the Act indicates any intention to limit agency discretion to permit changes from flow-through to normalization. No reason or purpose is suggested by the Act or its legislative history for Congress' undertaking to do so, and none exists.

THE FREEZE COMMENT

Unwarranted importance is placed by the lower Court on reference in the committee reports to a "'freeze' [of] the current situation regarding methods of depreciation." These statements are read by the Court below as indicating a congressional intent to prevent *any* changes in depreciation methods *or rate treatment* of such methods other than through the election provision. Specifically in this regard, the Court said:

> ". . . if we bear in mind the congressional intent generally "to freeze" the present depreciation situation, it appears logical that the permissible shift in accounting practices would be limited, . . .".[9] 462 F.2d at 870.

The reference in the House Report to a general "freeze" could not have been intended to preclude changes to normalization because the express language of the Act, as well as its stated purpose, was to the contrary. The lower Court recognized that under the House bill the taxpayer could discontinue flow-through with the consent of the regulatory

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[9] The lower court's interpretation is also contrary to the provisions of § 167 of the Internal Revenue Code which permits taxpayers, including regulated utilities, to shift from accelerated depreciation to straight-line depreciation at any time. Such changes are ordinarily made at the time when straight-line depreciation would exceed liberalized depreciation. The blanket prohibition against change which the lower Court reads into the Act would deny the utilities and their ate payers the benefits of this section.

agency. 462 F.2d at 862. Obviously the House contemplated no overall freeze and could not have intended the general "freeze" comment to have that effect. This language was simply carried forward with minor changes into subsequent Senate and Conference Committee Reports relating to their respective versions of the Act, both of which contained specific provisions for changes.

The "freeze" comment appears immediately following a reference to the suggestion of the Federal Power Commission that regulated utilities be required to use straight-line depreciation exclusively. The report explains that to do so would in many cases place the utilities at an unfair disadvantage, and then states that the committee had determined in general to freeze the current situation regarding methods of depreciation.

This, however, is not at all inconsistent with the continued discretion in the regulatory agency to permit a utility employing liberalized depreciation to base its rates on normalized taxes when the facts and circumstances justify such a change. Indeed, the term "current situation" may be interpreted as embracing not only the particular method of accounting used by the utility, but also the judicially recognized discretionary right in the regulatory agencies to permit a change to straight-line depreciation or normalization when current circumstances make it clear that liberalized depreciation would no longer result in a tax saving for the particular utility.

As Texas Gas notes, the "freeze" relates to changes from slower to faster methods of depreciation. As interpreted by the lower Court, however, it would prevent the Commission from ever giving effect to the *fact* that the 1964 conditions and circumstances of *Alabama-Tennessee* had changed to the extent that a different method was more appropriate.

Congress, having changed the tax laws so that liberalized depreciation would no longer result in a tax saving, it is anomolous to attribute to it the intention to deny the Federal Power Commission the discretionary authority to reflect the *effect* of such change by permitting the discontinuation of flow-through and thus protecting future customers against discriminatory rate treatment. Had Congress intended to limit agency discretion in this manner, it would surely have expressed itself more clearly than it did in the "freeze" comments on which the Court below placed such emphasis. Cf., *Alabama-Tennessee Natural Gas Co.* v. *F.P.C., supra,* 359 F.2d at p. 331.

THE ASSUMED DUTY

The lower Court further appeared to believe that the Commission was required to fix utility rates on the basis of "actual, present [tax] expenditures" alone. It stated that the Act did not purport to modify the Commission's "duty" to set rates on this basis. 462 F.2d at 863. The short answer to the lower court's comment is that the Commission has no such duty to be modified. It has been uniformly recognized that flow-through is inappropriate if, with respect to the particular utility, liberalized depreciation results in a tax deferral rather than a tax saving.[10] Addressing itself to this issue in *City of Chicago* v. *Federal Power Commission, supra,* the same court had stated:

> ". . . In some cases, normalization of tax deferrals is required lest future consumers be compelled to subsidize present consumers being served by the operations accruing tax liabilities." 385 F.2d at 633.

[10] See e.g., *City of Alton* v. *Commerce Commission,* 19 Ill. 2d 76, 165 N.E. 2d 513, cited and quoted from at length in both *Cities of Lexington, Kentucky et al* v. *FPC, supra* at p. 113 (which affirmed the Commission's approval of normalization) and *Alabama-Tennessee Natural Gas Co.* v. *FPC, supra* at p. 338 (which affirmed the Commission's requirement of flow-through).

Furthermore, the Court's assumption is contrary both to the Act itself which recognizes "normalization" as an appropriate method of fixing the rates of utilities which employ liberalized depreciation and to its affirmance of the Commission's Order No. 404, which permitted normalization for utilities which had made the election. This Court denied certiorari with respect to such holding in *Memphis Light, Gas & Water Division* v. *F.P.C.*, No. 72-96, October Term 1972.

CONCLUSION

For the reasons stated, the judgment of the lower Court should be reversed insofar as it vacated Commission's Opinions 578 and 578-A, and the action of the Commission in such Opinions should be affirmed.

Respectfully submitted,

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February 1, 1973

CERTIFICATE OF SERVICE

I certify that I have this day served the foregoing Motion for Leave to File Amicus Curiae Brief and Brief of The Independent Natural Gas Association of America, Amicus Curiae, in Support of Petitioners, on all parties to the proceedings in accordance with the requirements of this Court's Rule 33.

DATED at Washington, D. C. this first day of February, 1973.

/s/ JEROME J. McGRATH
JEROME J. McGRATH